Internal Revenue Service

Department of the Treasury

Washington, DC 20224

SIN 414.09-00

Person to Contact:

Telephone Number: TD#

Refer Reply to:
T:EP:RA:T2
Date: APR 18 2001

LEGEND:

Town A =

State B =

Plan X =

Plan Y =

Group C Employees =

Dear

This letter is in response to a request for a private letter ruling dated and revised by letter dated submitted on your behalf by your authorized representative, regarding the federal income tax treatment of certain contributions to Plan Y under section 414(h)(2) of the Internal Revenue Code (the "Code").

The following facts and representations have been submitted:

Town A, a municipal corporation of State B, initially adopted Plan X a money purchase pension plan for the benefit of its employees effective In order to provide enhanced benefits to its employees, Town A adopted Plan Y, a defined benefit plan for the benefit of its employees effective as of Plan Y covers any employees who previously were participants in Plan X who made an irrevocable election to participate in Plan Y and to

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transfer his or her account from Plan X to Plan Y (Collectively "Group C Employees").

Plan Y is intended to be qualified under section 401(a) of the Code and the related trust is intended to be exempt from federal income tax under section 501(c) of the Code. Plan Y was submitted to the Internal Revenue Service for a determination letter on

All employees of Town A, age 18 or older, who commence employment on or after may participate in Plan Y, if they make an irrevocable election to participate in Plan Y.

Plan Y requires mandatory employee contributions of eight percent on behalf of participating employees. Plan Y, by its terms, authorizes Town A, to pick up the contribution obligation of Group C employees and to make such contributions, in lieu of these employees paying such contributions.

Group C Employees will have no option to receive the picked-up contributions in cash instead of having such contributions paid by Town A to Plan Y.

Based on the aforementioned facts and representations, you have requested the following rulings:

1. That contributions made under Town A's pick up plan will be treated as employer contributions for federal income tax purposes.

2. That contributions made under Town A's pick up plan will be excluded from the employees' wages for purposes of federal income tax withholding.

3. That contributions made under Town A's pick up plan will not constitute gross income for federal income tax purposes until such time as they are distributed to the employees or their beneficiaries.

Section 414(h)(2) of the Code provides that contributions, otherwise designated as employee contributions, shall be treated as employer contributions if such contributions are made to a plan described in section 401(a), established by a state government or a political subdivision thereof, and are picked up by the employing unit.

The federal income tax treatment to be accorded contributions which are picked up by the employer within the meaning of section 414(h)(2) of the Code is specified in Revenue Ruling 77-462, 1977-2 C.B. 358. In that revenue ruling, the employer school district agreed to assume and pay the amounts employees were required by state law to contribute to a state pension plan. Revenue Ruling 77-462 concluded that the school district's picked-up contributions to the plan are excluded from the employees' gross income until such time as they are distributed to the employees. The revenue ruling held further that under the provisions of section 3401(a)(12)(A) of the Code, the school district's contributions to the plan are excluded from wages for purposes of the Collection of Income Tax at Source on Wages, therefore, no withholding is required from the employees' salaries with respect to such picked-up contributions.

The issue of whether contributions have been picked up by an employer within the meaning of section 414(h)(2) of the Code is addressed in Revenue Ruling 81-35, 1981-1 C.B. 255, and Revenue Ruling 81-36, 1981-1 C.B. 255. These revenue rulings established that the following two criteria must be met: (1) the employer must specify that the contributions, although designated as employee contributions, are being paid by the employer in lieu of contributions by the employee; and (2) the employee must not be given the option of choosing to receive the contributed amounts directly instead of having them paid by the employer to the pension plan.

Revenue Ruling 87-10, 1987-1 C.B. 136, provides that in order to satisfy Revenue Rulings 81-35 and 81-36, the required specification of designated employee contributions must be completed before the period to which such contributions relate. Thus, employees may not exclude from current gross income designated employee contributions to a qualified plan that relate to compensation earned for services prior to the date of the last governmental action necessary to effect the pick up.

Plan Y and Resolution 00-R-1 adopted by Town A satisfy the criteria set forth in Revenue Ruling 81-35 and Revenue Ruling 81-36 because it specifies that Town A will assume and pay mandatory employee contributions to Plan Y in lieu of contributions by Group C Employees and that Group C Employees may not elect to receive such contributions directly instead of having such contributions paid by Town A to Plan Y.

Accordingly, we conclude that:

1. The contributions made under Town A's pick up plan will be treated as employer contributions for federal income tax purposes.

2. The contributions made under Town A's pick up plan will be excluded from the employees' wages for purposes of federal income tax withholding.

3. The contributions made under Town A's pick up plan will not constitute gross income for federal income tax purposes until such time as they are distributed to the employees or their beneficiaries.

Because we have determined that the picked-up amounts are to be treated as employer contributions, such amounts are excepted from wages as defined in section 3401(a)(12)(A) of the Code for federal income tax withholding purposes. Therefore, no withholding of federal income tax is required from Group C Employees' salaries with respect to such picked-up contributions. For purposes of the application of section 414(h)(2) of the Code, it is immaterial whether Town A picks up contributions through a reduction in salary, an offset against future salary increases, or a combination of both.

These rulings apply only if the effective date for the commencement of any proposed pick up is not any earlier than the later of the date the Resolution is signed or the date it is put in effect.

These rulings are based on the assumption that Plan Y meets the requirements for qualification under section 401(a) of the Code at the time of the proposed contributions.

No opinion is expressed as to whether the amounts in question are subject to tax under the Federal Insurance Contributions Act. No opinion is expressed as to whether the amounts in question are paid pursuant to a "salary reduction" agreement within the meaning of section 3121(v)(1)(B) of the Code.

This letter ruling is directed only to the taxpayer that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

A copy of this letter is being sent to your authorized representative in accordance with a power of attorney on file in this office.

Sincerely yours,

(signed) JOYCE E. FLOYD
Joyce E. Floyd.
Manager, Employee Plans
Technical Group 2
Tax Exempt and Government
Entities Division

Enclosures:
Deleted copy of letter ruling
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